

1. FINANCIAL STATEMENT PRESENTATION.....	37
A. <i>Introduction.....</i>	<i>37</i>
B. <i>Statutory Basis.....</i>	<i>37</i>
C. <i>Governmental Fund Types.....</i>	<i>37</i>
D. <i>Fiduciary Fund Types.....</i>	<i>38</i>
E. <i>Account Groups.....</i>	<i>38</i>
2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES.....	38
A. <i>Statutory Basis of Accounting.....</i>	<i>38</i>
B. <i>Cash, Short-term Investments and Investments.....</i>	<i>39</i>
C. <i>Securities Lending Program.....</i>	<i>40</i>
D. <i>Receivables.....</i>	<i>40</i>
E. <i>Due from Cities and Towns.....</i>	<i>40</i>
F. <i>Dedicated Revenue.....</i>	<i>40</i>
G. <i>Inventories.....</i>	<i>41</i>
H. <i>General Fixed Assets.....</i>	<i>41</i>
I. <i>Interfund / Intrafund Transactions.....</i>	<i>41</i>
J. <i>Risk Management.....</i>	<i>41</i>
K. <i>Encumbrances.....</i>	<i>42</i>
L. <i>Fringe Benefit Cost Recovery.....</i>	<i>42</i>
M. <i>Lottery Revenue and Prizes.....</i>	<i>42</i>
N. <i>Fund Balances.....</i>	<i>42</i>
O. <i>Reclassification.....</i>	<i>43</i>
3. BUDGETARY CONTROL.....	43
4. DEPOSITS AND INVESTMENTS.....	45
A. <i>Financial Instruments with Off- Balance Sheet Risk.....</i>	<i>51</i>
5. SHORT-TERM FINANCING AND CREDIT AGREEMENTS.....	53
A. <i>General Fund.....</i>	<i>53</i>
B. <i>Capital Project Funds.....</i>	<i>53</i>
C. <i>Line-of-Credit Facilities.....</i>	<i>54</i>
6. LONG-TERM DEBT.....	55
A. <i>General Obligation Bonds.....</i>	<i>56</i>
i. <i>College Opportunity Bonds.....</i>	<i>56</i>
ii. <i>County Debt Assumed.....</i>	<i>56</i>
iii. <i>Variable Rate Demand Bonds.....</i>	<i>57</i>
iv. <i>Other Variable Rate Bonds.....</i>	<i>57</i>
v. <i>Auction Rate Securities.....</i>	<i>57</i>
B. <i>Special Obligation Bonds.....</i>	<i>58</i>
C. <i>Federal Highway Grant Anticipation Notes.....</i>	<i>58</i>
D. <i>Interest Rate Swap Agreements.....</i>	<i>59</i>
E. <i>Outstanding Debt.....</i>	<i>62</i>
F. <i>Bonds Defeased Through Refunding during FY05.....</i>	<i>64</i>
G. <i>Prior Defeasance.....</i>	<i>64</i>
H. <i>Statutory Debt Limit.....</i>	<i>64</i>
I. <i>Subsequent Bond Issuances.....</i>	<i>65</i>

7. LEASES	65
8. INDIVIDUAL FUND DEFICITS	66
9. MEDICAID COSTS.....	67
10. RETIREMENT SYSTEMS.....	68
A. <i>Primary Government</i>	<i>68</i>
B. <i>Plan Descriptions</i>	<i>68</i>
C. <i>Benefit Provisions</i>	<i>69</i>
D. <i>Funding Progress.....</i>	<i>69</i>
E. <i>Pension Actuarial Valuation.....</i>	<i>70</i>
F. <i>Contributions Required and Contributions Made.....</i>	<i>71</i>
G. <i>Post-retirement Health Care and Life Insurance Benefits</i>	<i>73</i>
11. COMMITMENTS	73
A. <i>MBTA and Other Authorities.....</i>	<i>73</i>
B. <i>Saltonstall Building</i>	<i>74</i>
C. <i>Central Artery / Tunnel Project</i>	<i>74</i>
12. CONTINGENCIES	74
A. <i>Tobacco Settlement</i>	<i>75</i>
B. <i>Unemployment Compensation Fund</i>	<i>75</i>
13. NON-TAX REVENUE INITIATIVES.....	76
A. <i>Debt Collection</i>	<i>76</i>
B. <i>Revenue Maximization.....</i>	<i>77</i>
C. <i>Cost Avoidance</i>	<i>77</i>
D. <i>Intercept</i>	<i>77</i>

1. FINANCIAL STATEMENT PRESENTATION

A. Introduction

The accompanying combined financial statements (Statutory Basis Financial Report) of the Commonwealth of Massachusetts (the Commonwealth) are presented in accordance with the requirements of Section 12 of Chapter 7A as amended by Section 4 of Chapter 88 of the Acts of 1997 of the Massachusetts General Laws. The Office of the Comptroller also publishes the Commonwealth's Comprehensive Annual Financial Report (CAFR) which is prepared in accordance with accounting principles generally accepted in the United States of America (GAAP) for governments. GAAP is prescribed by the Governmental Accounting Standards Board (GASB), the authoritative standard-setting body for establishing governmental accounting and financial reporting principles.

The Statutory Basis Financial Report (SBFR) includes all the budgeted and non-budgeted funds and account groups of the Commonwealth, as recorded by the Office of the Comptroller in compliance with Massachusetts General Laws and in accordance with the Commonwealth's budgetary principles.

The Statutory Basis Financial Report's Financial Statements are not intended to include independent authorities, non-appropriated funds of higher education or other organizations included in the Commonwealth's reporting entity as it would be defined under GAAP.

B. Statutory Basis

The Commonwealth reports its statutory basis financial position and results of operations in funds and account groups, each of which is considered a separate accounting entity. The operations of each fund are accounted for with a set of self-balancing accounts that comprise its assets, liabilities, fund balances, revenues and expenditures/expenses. Transactions between funds within a fund type, if any, have not been eliminated.

Account groups are accounting entities used to provide accountability for the Commonwealth's general fixed assets and long-term obligations. They are not considered funds because they do not report expendable available financial resources and related liabilities.

C. Governmental Fund Types

The Fund types and account groups are organized as follows:

Governmental Fund Types account for the general governmental activities of the Commonwealth.

Budgeted Funds – are the primary operating funds of the Commonwealth. They account for all budgeted governmental transactions. Major budgeted funds include the General and Highway funds, which are identified by the Comptroller as the operating funds of the Commonwealth.

Non-Budgeted Special Revenue Funds – are established by law to account for specific revenue sources that have been segregated from the budgeted funds to support specific governmental activities such as federal grants, funds related to the tobacco settlement and the operations of the state lottery.

Capital Projects Funds – account for financial resources used to acquire or construct major capital assets and to finance local capital projects. These

resources are derived from proceeds of bonds and other obligations, which are generally received after related expenditures have been incurred, operating transfers authorized by the Legislature and from federal reimbursements. Deficit balances in Capital Projects Funds represent amounts to be financed.

D. Fiduciary Fund Types

Fiduciary Funds account for assets held by the Commonwealth in a trustee capacity (Trust Funds), or as an agent (Agency Funds) for individuals, private organizations, other governmental units, and/or other funds.

Expendable Trust Funds – account for trusts whose principal and investment income may be expended for a designated purpose.

Nonexpendable Trust Funds – account for trusts whose principal cannot be spent.

Pension Trust Funds – account for the net assets available for plan benefits held in trust for the State Employees' and Teachers' Retirement Systems.

Agency Funds – account for assets the Commonwealth holds on behalf of others. Agency Funds are custodial in nature and do not involve measurement of operations.

E. Account Groups

Account Groups establish control and accountability over the Commonwealth's general fixed assets and long-term obligations.

General Fixed Assets Account Group – accounts for the general fixed assets of the Commonwealth and capital leases.

General Long-term Obligations Account Group – accounts for long-term bonds and notes issued by the Commonwealth and capital leases.

2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

A. Statutory Basis of Accounting

The SBFR is prepared from the Commonwealth's books and records and other official reports which are maintained on the basis of accounting used in the preparation of the Commonwealth's legally adopted annual budget (statutory basis). The statutory basis emphasizes accountability and budgetary control of appropriations. The SBFR is not intended to present the Commonwealth's financial condition and results of operations in conformity with GAAP. Under GAAP, the books are accounted for using a current financial resources measurement focus and the modified accrual basis of accounting.

Under the statutory basis of accounting, revenues are generally recognized when cash deposits are received by the Treasury. However, revenues receivable for federal grants and reimbursements are recognized when related expenditures are incurred. Amounts due from political subdivisions of the Commonwealth are recognized when considered measurable and available. Deeds excise taxes are recognized at the time of collection by the counties and the Commonwealth.

Under the statutory basis of accounting, expenditures are generally recorded when the related cash disbursement occurs. At year-end, payroll is accrued and payables are recognized, to the extent of approved encumbrances, for goods or

services received by June 30. Costs incurred under the federally-sponsored Medicaid program, amounts required to settle claims and judgments against the Commonwealth, and certain other liabilities are not recognized until they are encumbered or otherwise processed for payment. Under GAAP, expenditures are recorded in the period in which the related fund liability is incurred.

The Pension Trust Funds are reported using a flow of economic resources measurement focus and the accrual basis of accounting on both the statutory and GAAP basis. Under this method, additions are recorded when earned and deductions are recorded at the time liabilities are incurred. This measurement focus emphasizes the determination of net change in assets available for pension benefits.

The accounting policies followed in preparing the accompanying statutory basis financial report are described in the remainder of this section.

**B. *Cash, Short-term
Investments and
Investments***

The Commonwealth follows the practice of pooling the cash and cash equivalents of its Governmental and Fiduciary Funds. Cash equivalents consist of short-term investments with an original maturity of three months or less and are stated at cost. Interest earned on pooled cash is allocated to the General Fund, Expendable Trust Funds and, when so directed by law, to certain Special Revenue and Capital Projects Funds.

The Office of the Treasurer and Receiver-General (Treasury) manages the Commonwealth's short-term investment pool. Statutes authorize investment in obligations of the U. S. Treasury, authorized bonds of all states, banker's acceptances, certificates of deposit, commercial paper rated within the three highest classifications established by Standard & Poor's Corporation and Moody's Commercial Paper Record and repurchase agreements that any of these obligations secure. Such investments are carried at cost, which approximates fair value.

The Pension Trust Funds, with investments of approximately \$37,702,829,000 at fair value and the Health Care Security Trust Account investments of approximately \$156,655,000 at fair value, are permitted to make investments in equity securities, fixed income securities, real estate, timber and other alternative investments. For investments traded in an active market, the fair value of the investment will be its market price. The Pension Trust Funds include investments in real estate, venture capital funds, real estate funds, limited partnerships, futures pools, international hedge pools, commodities pools, balanced pools, leveraged buyouts, private placements and other alternative investments. The structure, risk profile, return potential and marketability differ from traditional equity and fixed income investments. Concentration of credit risk exists if a number of companies in which the fund has invested are engaged in similar activities and have similar economic characteristics that could cause their ability to meet contractual obligations to be similarly affected by changes in economic or other conditions. To mitigate the exposure to concentrations of risk, the Pension Trust Funds invest in a variety of industries located in diverse geographic areas. As of June 30, 2005, the estimated fair values, determined by management with input from the investment managers, of these real estate and alternative investments were \$7,505,233,000 of the Pension Trust Funds, representing 18.8% of the total assets of the Fiduciary Fund Type.

Other investments, mainly in escrows, the Pension Trust Funds and the Health Care Security Trust Fund (HST) are reported as fair value in the financial statements. The investments of the Pension Trust Funds are held separately from those of other Commonwealth funds, with the exception of their investments in the Massachusetts Municipal Depository Trust (MMDT). The Pension Trust Funds and the HST are permitted to make investments in equity securities, fixed income securities, real estate and other alternative investments.

C. Securities Lending Program

The Pension Trust Funds participate in securities lending programs. Under these programs, the Trusts receive a fee for allowing brokerage firms to borrow certain securities for a predetermined period of time, securing such loans with cash or collateral typically equaling 102% to 105% of the fair value of the security borrowed. The collateral securities cannot be pledged or sold by the Pension Reserve Investment Trust (PRIT) unless the lending agents default. The lending agents are required to indemnify PRIT in the event that they fail to return the securities on loan (and if the collateral is inadequate to replace the securities on loan) or if the lending agents fail to perform their obligations as stipulated in the agreements. There were no losses resulting from default of the lending agents during the years ending June 30, 2005 and 2004. At June 30, 2005, the fair value of the securities on loan from PRIT was approximately \$1,877,595,000. The fair value of the collateral held by PRIT amounted to \$1,953,412,000 at June 30, 2005, of which \$1,101,100,000 was cash.

D. Receivables

Receivables are stated net of estimated allowances for uncollectible accounts. Reimbursements due to the Commonwealth for its expenditures on federally funded reimbursement and grant programs are reported as "Due from federal government."

E. Due from Cities and Towns

Represents reimbursement due to the Commonwealth for its expenditures on certain programs for the benefit of cities and towns.

On July 9, 2004, the Governor signed Chapter 169 of the Acts of 2004, related to the financial ability of the City of Springfield. Section 2 of the Act provides for \$52,000,000 in zero interest loans to be drawn from time to time by a finance control board established by the act. This activity is recorded in the Springfield Fiscal Recovery Trust Fund, a non-budgeted fund. The loans are to be paid back to the Commonwealth no later than June 30, 2012. During FY2005, \$100,000,000 in cash flow was issued to the City from the Trust Fund. Of this amount, \$78,000,000 was repaid to the Commonwealth before June 30, 2005 and the remaining \$22,000,000 is reflected as "Due from Cities and Towns." It is anticipated that this revolving activity will continue for the foreseeable future. The Act provides for no forgiveness of the loans and failure to repay the full value of loans disbursed from the fund to the city shall result in an equally commensurate reduction in local aid payments made by the Commonwealth to the City in FY2013.

F. Dedicated Revenue

The Commonwealth has various streams of dedicated revenues reflected in non-budgeted fund activity. Approximately \$2.0 billion in revenues from federal grants passed through the Federal Grants Fund represents the greatest source of dedicated revenues. The largest pledge of tax revenues apportions a "dedicated sales tax" amounting to 1% of applicable sales in the Commonwealth directly to the Massachusetts Bay Transportation Authority (MBTA). Total dedicated sales tax revenue directed to the MBTA in FY05 was approximately \$704,809,000.

In FY05, the legislature began phasing in a dedication of sales tax revenues

amounting to 1% of applicable sales. \$395,700,000 of dedicated sales tax revenue was pledged to fund school construction via a transfer to the Massachusetts School Building Authority. This amount rises to a minimum of \$488,700,000 or 70% of dedicated sales taxes, whichever is larger in FY2006. In future years these amounts rise further per statute until 1% of applicable sales is pledged in FY2011.

Other major dedicated tax revenue streams include surcharges from areas contiguous to convention centers to support such centers' operations, motor fuels taxes to support highway construction, repairs and maintenance and cigarette taxation to support health and human service costs.

G. Inventories

The costs of materials and supplies are recorded as expenditures in Governmental Funds when purchased. Such inventories are not material in total to the financial statements and therefore are not presented.

H. General Fixed Assets

General fixed asset acquisitions are recorded as expenditures in the acquiring fund and capitalized in the General Fixed Assets Account Group in the year purchased. General fixed assets are recorded at historical cost, or at estimated historical cost if actual historical cost is not available. Donated fixed assets are recorded at estimated fair market value at the date of donation.

The cost of normal maintenance and repairs that do not add to the value of the assets or materially extend asset lives are not capitalized. Improvements are capitalized.

The Commonwealth capitalizes all land except land associated with infrastructure. It capitalizes buildings and equipment, including computer software, with a cost in excess of \$100,000 and \$50,000 respectively at the date of acquisition and with an expected useful life greater than one year. Public domain general fixed assets and infrastructure (roads, bridges, tunnels, dams, water and sewer systems, etc.) are not capitalized. Interest incurred during construction is not material and is not capitalized. Under the statutory basis of accounting, no depreciation is taken on general fixed assets.

I. Interfund / Intrafund Transactions

During the course of its operations, the Commonwealth records transactions between funds and / or between departments. On the statutory basis, transactions between Governmental and Fiduciary Fund Types are recorded as adjustments to the funds' cash accounts. As a result, a fund may report a deficiency in cash and short-term investments.

Transactions of a buyer/seller nature between departments within a fund are not eliminated.

Transfers in and out net to approximately \$4,638,000 due to higher education non-appropriated fund activity, which is not included in the combined statements – statutory basis.

J. Risk Management

The Commonwealth does not insure for state employees workers' compensation, casualty, theft, tort claims and other losses. Such liabilities are not recognized on the statutory basis until encumbered and / or processed for payment. For employees workers' compensation, the Commonwealth assumes the full risk of claims filed under a program managed by the Human Resources Division. For personal injury or property damages, Chapter 258 of the Massachusetts General Laws (General Laws) limits the risk assumed by the Commonwealth to

\$100,000 per occurrence, in most circumstances. The Group Insurance Commission administers contributory health care and other insurance programs for the Commonwealth's employees and retirees.

K. *Encumbrances*

Encumbrance accounting is utilized in the Governmental Fund Types as a significant aspect of budgetary control. The full amounts of purchase orders, contracts and other commitments of appropriated resources are encumbered and recorded as deductions from appropriations prior to actual expenditure, ensuring that such commitments do not exceed appropriations. Encumbrances outstanding at year-end for goods or services received on or before June 30 are reported as expenditures and statutory basis liabilities as a component of accounts payable.

L. *Fringe Benefit Cost Recovery*

The Commonwealth appropriates and pays the fringe benefit costs of its employees and retirees through the General Fund. These fringe benefits include the costs of employees' health insurance, pensions, unemployment compensation, and other costs necessary to support the state work force. As directed by Chapter 29, Sections 5D and 6B(f) of the Massachusetts General Laws, these costs are assessed to other funds based on their payroll costs, net of credits for direct payments. Since these fringe benefit costs and pensions are not appropriated in the budget, the required assessment creates a variance between budget and actual expenditures at year-end. The fringe benefit cost recoveries of \$215,338,000 in the budgeted funds result from costs assessments of \$140,800,000 in the governmental fund types and the expendable trust funds. The remainder of \$74,538,000 is assessed to the higher education non-appropriated activity, which is not included in the statutory basis financial report.

M. *Lottery Revenue and Prizes*

Ticket revenues are recognized when sold and prizes awarded by the Massachusetts Lottery Commission are recognized as drawings are held.

N. *Fund Balances*

The Commonwealth reports fund balances as reserved where legally restricted for a specific future use. Otherwise, these balances are considered unreserved.

Fund balance has been reserved as follows:

"Reserved for continuing appropriations" – are unexpended amounts in appropriations, which the Legislature has specifically authorized to be carried into the next FY.

"Reserved for Commonwealth stabilization" – are amounts set aside in the Commonwealth Stabilization Fund in accordance with 5C of Chapter 29 of the Massachusetts General Laws.

"Reserved for transitional escrow" – are funds set aside by Section 16 of Chapter 106, Acts of 2005 for expenditure subject to appropriation by June 30, 2006 with any unexpended balance returned to the Commonwealth Stabilization Fund.

"Reserved for debt service" – are amounts held by fiscal agents or the Commonwealth to fund future debt service obligations.

"Reserved for employees' pension benefits" – are the net assets of the Commonwealth's public employee retirement systems which cannot be used for any other purpose.

“Reserved for unemployment benefits” – are amounts reserved for payment of unemployment compensation.

“Reserved for capital projects” - are amounts reserved for capital projects.

Unreserved fund balance is segregated into two components:

“Designated for specific purpose” – are all unreserved fund balances for which the Legislature or Executive Branch has evidenced an intention to restrict for a specific purpose.

“Undesignated” – consists of cumulative surpluses or deficits of the Governmental Fund Types not otherwise designated.

O. *Reclassification*

Certain reclassifications have been made to the FY2004 account balances to conform to the presentation in FY2005.

3. BUDGETARY CONTROL

State finance law requires that a balanced budget be approved by the Governor and the Legislature. The Governor presents an annual budget to the Legislature, which includes estimates of revenues and other financing sources and recommended expenditures and other financing uses. The Legislature, which has full authority to amend the budget, adopts an expenditure budget by appropriating monies at the individual appropriation account level in an annual appropriations act.

Before signing the appropriations act, the Governor may veto or reduce any specific item, subject to legislative override. Further changes to the budget established in the annual appropriations act may be made via supplemental appropriation acts or other legislative acts. These must also be signed by the Governor and are subject to the line item veto.

In addition, Massachusetts General Laws authorize the Secretary of Administration and Finance, with the approval of the Governor, upon determination that available revenues will be insufficient to meet authorized expenditures, to withhold allotments of appropriated funds which effectively reduce the account’s expenditure budget.

The majority of the Commonwealth’s appropriations are non-continuing accounts which lapse at the end of each fiscal year. Others are continuing accounts for which the Legislature has authorized that an unspent balance from the prior year be carried forward and made available for spending in the current fiscal year. In addition, the Legislation may direct that certain revenues be retained and made available for spending within an appropriation. Fringe benefits, pension costs, and certain other costs which are mandated by state finance law are not itemized in the appropriation process and are not separately budgeted.

Because revenue budgets are not updated subsequent to the original appropriation act, the comparison of the initial revenue budget to the subsequent, and often modified, expenditure budget can be misleading. Also, these financial statements portray fund accounting with gross inflows and outflows, thus creating a difference to separately published budget documents. In conducting the budget process, the Commonwealth excludes those interfund transactions that by their nature have no impact on the combined fund balance of the budgeted funds. An example of this is the lack of a budget for pension costs.

Generally, expenditures may not exceed the level of spending authorized for an appropriation account. However, the Commonwealth is statutorily required to pay debt service, regardless of whether such amounts are appropriated.

The FY04 General Appropriation Act (Chapter 26, Section 167 of the Acts of 2003), amended section 9C, directing the Governor to notify the Legislature in writing as to the reasons for and the effect of any reductions in spending. Alternatively, the Governor may propose specific additional revenues to fund the deficiency. The Governor may also propose to transfer funds from the Stabilization Fund to cure the deficiency. This proposal must be delivered to the Legislature 15 days before any reductions take effect.

The following table summarizes budgetary activity for FY05 (amounts in thousands):

	<u>Revenues</u>	<u>Expenditures</u>
General Appropriation Act, Chapter 149 of the Acts of 2004:		
Direct appropriations.....	\$ 22,548,599	\$ 21,281,758
Estimated revenues, transfers, direct appropriations retained revenue appropriations, interagency chargebacks and appropriations carried forward from FY2004	1,438,101	1,818,140
Total original budget.....	23,986,700	23,099,898
Supplemental Acts of 2004:		
* Chapter 352.....	-	(750)
Chapter 462.....	-	350
Chapter 502.....	-	3,271
Supplemental Acts of 2005:		
Chapter 65.....	-	118,544
Chapter 35.....	-	79,568
Chapter 81.....	-	25,000
Total before June 30, 2005	23,986,700	23,325,881
Supplemental Acts of 2005, passed after June 30:		
Chapter 106	-	129,447
Total budgeted revenues and expenditures per Legislative action	23,986,700	23,455,328
Plus: Transfers of revenues and expenditures (including rounding).....	-	1,986,736
Budgeted revenues and expenditures as reported.....	\$ 23,986,700	\$ 25,442,064

* The negative supplemental appropriation is the outcome of a pilot program implemented at certain state college institutions whereby they were allowed to retain and spend out - of - state tuitions. The offsetting estimated state savings was reduced from the institutions original General Appropriation Act allocation.

The following table identifies the interfund activity from budgeted sources and uses to reconcile forecasts prepared during the budget process to the results presented in these statements: (amounts in thousands)

	Revenues and Other Financing Sources	Expenditures and Other Financing Uses
Actual as presented in the combined budget and actual statement - statutory basis.....	\$ 26,604,656	\$ 26,010,274
Adjustments to revenues and expenditures		
Transfer to the Intragovernmental Service Fund revenues.....	(185,859)	(185,859)
Adjustments to other financing sources and uses:		
Fringe benefit cost assessments.....	(52,019)	(52,019)
Year-end Stabilization Transfer.....	(85,959)	(85,959)
Transfer from the Intragovernmental Service Fund to the General Fund.....	(1,927)	(1,927)
RMV license plates.....	(3,513)	(3,513)
Transfer from the Federal Medicaid Assistance Percentage Escrow Fund to the General Fund.....	(270,000)	(270,000)
Stabilization transfers to the General Fund.....	(343,271)	(343,271)
Excess Permissible Tax Revenue Transfer from General Fund to Temporary Holding Fund.....	(135,991)	(135,991)
Year-End Excess Permissible Tax Revenue Transfer from Temporary Holding Fund to Stabilization Fund	(135,991)	(135,991)
Transfers to the Transitional Escrow Fund per Chapter 106 of the Acts of 2005.....	(304,838)	(304,838)
Transfers to the Stabilization Fund per Chapter 106 of the Acts of 2005	(691,000)	(691,000)
Other	(20,855)	(20,855)
Actual as presented on budgetary documents.....	\$ 24,373,433	\$ 23,779,051

The section divider for the budgeted funds contains a list of budgeted funds grouped by categories.

The Office of the Comptroller has the responsibility to ensure that budgetary control is maintained on an individual appropriation account basis. Budgetary control is exercised through the state accounting system, Massachusetts Management Accounting and Reporting System (MMARS). Encumbrances and expenditures are not allowed to exceed the appropriation account's spending authorization.

4. DEPOSITS AND INVESTMENTS

The Commonwealth maintains a cash and short-term investment pool that is available for use by all funds. Each fund type's net equity in this pool is displayed on the combined balance sheet as either "Cash and short-term investments" or "Deficiency in cash and short-term investments." The investments of the Pension Trust Funds are held in a separate trust.

The Treasury manages the Commonwealth's short-term investment pool. Statutes authorize investment in obligations of the U.S. Treasury, authorized bonds of all states, banker's acceptances, certificates of deposit, commercial paper rated within the three highest classifications established by two or more nationally recognized statistical rating organizations and repurchase agreements that any of these obligations secure. Such investments are carried at cost, which approximates fair value.

Pooled cash and short-term investments include the following (amounts in thousands):

Cash and short-term investments.....	\$ 6,952,051
Cash with fiscal agent.....	967,712
Cash on deposit with U. S. Treasury.....	414,998
Deficiency in cash and short-term investments.....	<u>(1,841,923)</u>
Total.....	<u>\$ 6,492,838</u>

Other investments, mainly in escrows, the Pension Trust Funds and the HST are reported at fair value in the financial statements. The investments of the Pension Trust Funds are held separately from those of other Commonwealth funds, with the exception of their investments in the Massachusetts Municipal Depository Trust (MMDT). The Pension Trust Funds and the HST are permitted to make investments in equity securities, fixed income securities, real estate and other alternative investments. In the following table these alternative investments, venture capital and futures pools are classified as other investments.

Interest Rate Risk – Non Pension Trust Funds

Interest rate risk is the extent that changes in interest rates of debt investments will adversely affect the fair value of an investment. The following table (in thousands of dollars) provides information about the interest rate risk associated with the Commonwealth's investments, exclusive of its Pension Trust Funds but inclusive of the Health Care Security Trust, which is managed by PRIT. These investments include certain short – term cash equivalents, various long-term items and restricted assets by maturity in years. The Treasury minimizes the risk of the market value of securities falling due to changes in interest rates by maintaining an effective duration of less than 90 days and holding all of the portfolio's total market value in securities with a maturity of six months or less. Because of the short – term nature of these investments, they are defined as cash equivalents. Therefore, they are not investments.

Credit Risk – Non – Pension Trust Funds

Credit risk is the risk that an issuer or other counterparty to an investment will not fulfill its obligations. The Commonwealth, exclusive of Pension Trust Funds, minimizes concentration of credit risk, the risk attributed to the magnitude of the investment in a single issuer. The Commonwealth's investment policy prohibits the Treasury from investing more than 10% of the total investment portfolio into any single financial institution or issuer, excluding various public entity securities and repurchase agreements. There are no restrictions in the amount that can be invested in public entity securities; however, the portfolio may be invested in U.S. Treasury obligations and repurchase agreements. During FY05, the Commonwealth, exclusive of Pension Trust Funds, maintained an investment with Sovereign Bank, which was valued at 9.1% of the portfolio's total fair value as of June 30, 2005. This investment contains funds in a daily reset account with interest accruing at the London Inter- Bank Offered Rate (LIBOR).

The Treasury requires investments in commercial paper and bankers' acceptances have the highest letter and numerical ranking as rated by nationally recognized statistical ratings organizations as defined by the investment act of 1940. The Treasury does not have any additional policies regard credit ratings of investments. The following table (in thousands of dollars) provides information on the credit ratings associated with the Commonwealth's investments in debt securities:

<u>Rated and Unrated Investments</u>	<u>Fair Value</u>	<u>Quality Ratings</u>	
		<u>A1 / P1</u>	<u>Unrated</u>
Certificates of deposit.....	\$ 461,588	\$ 45,188	\$ 416,400
Yankee dollars, foreign banks.....	588,159	588,159	-
Commercial paper.....	1,842,747	1,842,747	-
Federal agencies.....	30,096	30,096	-
Master note agreements.....	10,845	10,845	-
Medium term notes.....	570,247	570,247	-
Repurchase agreements.....	426,837	-	426,837
Other deposits, assets and liabilities, net.....	474,326	-	474,326
Total Fixed Income Investments.....	\$ 4,404,845	\$ 3,087,282	\$1,317,563

Interest Rate Risk – Pension Trust Funds

As pension trust funds have a different investment horizon, the PRIM Board manages PRIT's exposure to fair value loss arising from movements in interest rates by establishing duration guidelines with its debt securities investment managers. The guidelines with each individual manager require that the duration of the domestic debt investment portfolio be within a specified percentage or number of years of the duration band of the appropriate benchmark index. For emerging markets fixed income investments, the portfolio must have a duration with a band ranging from three to eight years.

Effective duration is a measure of a fixed income investment's exposure to fair value changes arising from changes in interest rates. Effective duration makes assumptions regarding the most likely timing and amounts of variable cash flows. These assumptions take into consideration factors indicative of investments highly sensitive to interest rate changes, including callable options, prepayments and other factors. These factors are reflected in the effective durations numbers provided in the table on the following page.

The PRIM Board compares the effective duration of a manager's portfolio to the Lehman Brothers Aggregate Index for domestic core "fixed income" securities and the Merrill Lynch High Yield Master II Index for domestic high yield fixed income securities. At June 30, 2005, the following table shows the debt investments by investment type, fair value and effective weighted duration rate.

<u>Investment</u>	<u>Fair Value</u>	<u>Effective Weighted Duration Rate (Years)</u>
Asset backed securities.....	\$ 198,820	2.08
Commercial mortgage backed securities.....	142,051	3.66
Non-U. S. Government backed C.M.O.s.....	56,128	3.92
Commercial paper.....	62,960	0.11
Corporate bonds and other credits.....	2,945,971	3.83
U.S. Government bonds.....	774,531	5.73
U.S. Government agencies.....	336,781	2.27
U.S. Government TIPS.....	1,743,098	6.15
U.S. Government mortgage backed securities.....	1,652,586	2.35
Municipal bonds.....	16,706	9.72
Pooled money market fund.....	908,415	0.08
Other pooled funds.....	<u>790,782</u>	<u>NA</u>
Total fixed income and short-term investments.....	<u>\$ 9,628,829</u>	

Credit Risk - Pension Trust Funds

The PRIM Board establishes credit investment guidelines with each of its fixed income securities investment managers in establishing a diversified portfolio. These guidelines vary depending on the manager's strategy and the role of its portfolio to the overall diversification of the PRIT fund. The guidelines for the PRIT Fund's core fixed income portfolio establish the minimum credit rating for any security in the portfolio and the overall weighted average credit rating of the portfolio. The guidelines for the PRIT Fund's high yield, fixed income portfolio establish a market value range of securities to be held with a specific minimum credit rating and the overall weighted average credit rating of the portfolio.

The weighted quality average rating of the debt securities portfolio, excluding pooled investments, investments explicitly backed by the United States Government and other nonrated investments was A - at June 30, 2005.

The following presents the PRIT Fund's debt securities credit ratings at June 30, 2005:

<u>Investment</u>	<u>Fair Value</u>	<u>AAA</u>	<u>AA+ to AA-</u>	<u>A+ to A-</u>	<u>BBB+ to BBB-</u>	<u>BB+ to Unrated</u>
Asset backed securities.....	\$ 198,820	\$ 188,287	\$ -	\$ -	\$ -	\$ 10,533
Commercial mortgage backed securities.....	142,051	134,446	1,028	-	-	6,577
Non-U.S. government backed C.M.O.s.....	56,128	50,324	-	-	-	5,804
Commercial paper.....	62,960	60,678	-	-	-	2,282
Corporate bonds and other credits.....	2,945,971	163,083	146,974	254,539	537,465	1,843,910
U.S. government agencies.....	336,781	335,301	1,480	-	-	-
U.S. government backed securities.....	1,566,771	1,502,868	-	-	-	63,903
Municipal bonds.....	16,706	3,286	4,047	-	9,373	-
Pooled money market fund.....	908,415	-	908,415	-	-	-
Other pooled funds.....	<u>790,782</u>	-	-	-	-	790,782
Total credit risk, fixed income and short-term investments.....	7,025,385	<u>\$ 2,438,273</u>	<u>\$1,061,944</u>	<u>\$ 254,539</u>	<u>\$ 546,838</u>	<u>\$ 2,723,791</u>
Fixed income investments explicitly backed by the U.S. Government.....	<u>2,603,444</u>					
Total fixed income and short-term investments.....	<u>\$ 9,628,829</u>					

Foreign Currency Risk – Pension Trust Funds

Foreign Currency risk is the risk that changes in exchange rates will adversely affect the fair value of investments. The Treasury does not have a policy regarding foreign currency risk. The PRIM Board manages PRIT's exposure to foreign currencies by holding a percentage of PRIT's non-U.S. dollar denominated investments to U.S. dollars through forward foreign currency contracts. The following table on the next page represents PRIT's foreign currency exposure at June 30, 2005:

Continued

	Cash and Short-Term Investments	Equity	Fixed Income	Alternative Investments	Total
Argentine Peso.....	\$ 54	\$ 326	\$ -	\$ -	\$ 380
Australian Dollar.....	8,827	221,406	776	-	231,009
Brazilian Real.....	1,236	159,214	-	-	160,450
British Pound.....	14,448	1,300,740	4,568	-	1,319,756
Canadian Dollar.....	3	-	1,338	-	1,341
Chilean Peso.....	168	8,778	-	-	8,946
Columbian Peso.....	27	4,088	-	-	4,115
Czech Coruna.....	16	2,833	-	-	2,849
Danish Krone.....	528	59,084	-	-	59,612
Egyptian Pound.....	1,470	11,247	-	-	12,717
Euro.....	26,676	1,742,675	50,635	-	1,819,986
Greek Drachma.....	4	-	-	-	4
Hong Kong Dollar.....	1,656	270,597	400	-	272,653
Hungarian Forint.....	106	10,424	-	-	10,530
Indian Rupee.....	-	375	-	-	375
Indonesian Rupian.....	26	43,940	-	-	43,966
Israeli Shekel.....	98	17,711	-	-	17,809
Japanese Yen.....	10,297	1,268,502	1,487	-	1,280,286
Malaysian Ringgit.....	896	89,023	-	-	89,919
Mexican Peso.....	29	49,905	-	-	49,934
Taiwan Dollar.....	4,128	174,257	-	-	178,385
Turkish Lira.....	77	42,772	-	-	42,849
New Zealand Dollar.....	538	18,499	-	-	19,037
Norwegian Krone.....	611	27,096	-	-	27,707
Pakistan Rupee.....	-	2,438	-	-	2,438
Peruvian Nuevo Sol.....	-	1,411	-	-	1,411
Philippines Peso.....	104	11,738	-	-	11,842
Polish Zloty.....	102	24,023	-	-	24,125
Russian Rubel.....	-	918	-	-	918
South African Rand.....	500	188,415	14	-	188,929
Singapore Dollar.....	873	75,057	-	-	75,930
South Korean Won.....	1,083	432,351	-	-	433,434
Swedish Krona.....	2,562	170,633	-	-	173,195
Swiss Franc.....	4,186	274,105	-	-	278,291
Thailand Baht.....	78	43,436	-	-	43,514
Alternative investment funds denominated in foreign currencies (various currencies).....	-	-	-	284,155	284,155
International equity pooled funds (various currencies).....	-	295,173	-	-	295,173
International fixed income pooled funds (various currencies).....	-	-	58,424	-	58,424
Total securities subject to foreign currency risk.....	81,407	7,043,190	117,642	284,155	7,526,394
International investments denominated in U.S. Dollars.....	-	808,216	1,139,831	-	1,948,047
Total international investments, deposits and cash.....	\$ 81,407	\$ 7,851,406	\$1,257,473	\$ 284,155	\$ 9,474,441

Concentration of Credit Risk – Pension Trust Funds

The PRIM Board manages PRIT's exposure to concentration of credit risk by establishing guidelines with each investment manager, that limit the percent of investment in any single issue or issuer.

PRIT has no investments at fair value, that exceed 5% of PRIT's net assets held in trust for pool participants as of June 30, 2005.

**A. *Financial Instruments
with Off-Balance
Sheet Risk***

PRIT may invest in other off-balance sheet transactions. These investments of the Commonwealth may involve a degree of risk not accounted for on the respective financial statements. Descriptions of such "off-balance sheet risks" are as follows:

Forward Currency Contracts

The Pension Trust Funds enter into forward currency contracts to hedge the exposure to changes in foreign currency exchange rates on foreign portfolio holdings. The market value of the contract will fluctuate with changes in currency exchange rates. Risks may arise upon entering these contracts from the potential inability of counterparties to meet the terms of their contracts and from unanticipated movements in the value of a foreign currency relative to the U.S. dollar.

The contract is marked-to-market daily and the change in market value is recorded by the fund as an unrealized gain or loss by the Pension Trust Fund.

When the contract is closed, the Pension Trust Funds record a realized gain or loss equal to the difference between the value of the contract at the time it was opened and the value at the time it was closed. Fluctuations in the value of forward currency contracts are recorded as unrealized gains or losses by the Pension Trust Funds.

As of June 30, 2005, PRIT had open foreign exchange contracts with combined net unrealized gains of \$17,768,000 with various delivery dates to November, 2005.

Futures Contracts

The Pension Trust Funds may purchase and sell financial futures contracts to hedge against changes in the values of securities the fund owns or expects to purchase. Upon entering such contracts, they must pledge to the broker an amount of cash or securities equal to a percentage of the contract amount.

The potential risk is that the change in the value of futures contracts primarily corresponds with the value of underlying instruments, which may correspond to the change in value of the hedged instruments. In addition, there is a risk that PRIT may not be able to close out its future positions due to a non-liquid secondary market. Risks may arise from the potential inability of a counterparty to meet the terms of a contract and from unanticipated movements in the value of a foreign currency relative to the U.S. dollar.

The Pension Trust Funds may also invest in financial futures contracts for non-hedging purposes.

Payments are made or received by the Pension Trust Funds each day, depending on the daily fluctuations in the value of the underlying security and are recorded as unrealized gains or losses. When the contracts are closed, the Pension Trust Funds recognize a realized gain or loss.

Options

PRIT is also engaged in selling or “writing” options. The Pension Trust Funds, as writers of options, may have no control over whether the underlying securities may be sold (call) or purchased (put) and, as a result, bear the market risk of an unfavorable change in the price of the security underlying the written option. As of June 30, 2005, there were no material options outstanding.

5. SHORT-TERM FINANCING AND CREDIT AGREEMENTS

Massachusetts General Laws authorize the Treasurer to issue temporary notes in anticipation of revenue or bond financing. When this short-term debt does not meet long-term financing criteria, it is classified as a fund liability. Short-term debt may be issued on either a stand-alone basis or through a commercial paper program maintained by the Commonwealth.

A. General Fund

The balance of revenue anticipation notes (RANs) outstanding may fluctuate during a fiscal year, but must be reduced to zero at June 30. During FY05, the Commonwealth issued RANs through its commercial paper program on a periodic basis to meet cash flow needs. A maximum of \$700,000,000 of RANs were outstanding at any time during the year. All RANs were retired before the end of June 2005.

B. Capital Project Funds

The Commonwealth may issue bond anticipation notes (BANs) to temporarily finance its capital projects. BANs may be issued either on a stand-alone basis or through the Commonwealth's commercial paper program.

Beginning in FY03 and continuing through FY05, the Commonwealth periodically issued BANs through the commercial paper program. BANs were rolled over and paid down at various times during the fiscal year. No more than \$375,100,000 of BANs were outstanding under the commercial paper program at any time during FY05. At June 30, 2005, BANs totaling \$140,100,000 remain outstanding.

On March 28, 2002, \$180,000,000 in General Obligation BANs were also issued to finance costs of the Central Artery / Tunnel Project, in advance of receiving certain contributions from the Massachusetts Port Authority (Massport). The majority of the BANs were retired previous to FY2005. During June 2003, Massport delivered to the Commonwealth \$104,900,000 pursuant to Section 12 of Chapter 81A of the General Laws and the Roadway Transfer Agreement dated as of March 23, 1999, as amended (the "Transfer Agreement") among Massport, the Commonwealth, acting by and through the Massachusetts Highway Department, and the Massachusetts Turnpike Authority. This payment of \$104,900,000 was applied to retire a portion of the commercial paper BANs. \$75,100,000 of such BANs remains outstanding as of June 30, 2005 and represent a component of the \$140,100,000 in BANs outstanding.

On December 31, 2003, Massport was expected to make an additional payment to the Commonwealth under the Transfer Agreement of \$50,000,000. This payment was received and applied in August of 2005, leaving a balance of BANs of \$25,100,000. A final payment of \$50,000,000 was due on December 31, 2004 under the Transfer Agreement only to the extent that Massport has received assets of commensurate value. Massport has informed the Commonwealth that such assets have not been received and that Massport therefore will withhold the final payment until such assets are transferred. Massport and the Commonwealth have not agreed on a scheduled date of payment.

C. Line-of-Credit Facilities

During FY05, the Commonwealth maintained line-of-credit facilities to provide liquidity support for commercial paper notes totaling \$1,000,000,000. The Commonwealth has a total of five line-of-credit facilities to provide such liquidity support, each in the amount of \$200,000,000. These facilities expire in periods from September 2005, through November 2015 at various times, with an optional termination at January 2010. The annual cost of these facilities ranges from 0.12% to 0.16%.

The following schedule details short – term financing and credit agreement activity, net, for all funds for the fiscal year (amounts in thousands):

	Beginning Balance July 1, 2004	Issued / Drawn	Redeemed / Repaid	Ending Balance June 30, 2005	Credit Limit June 30, 2005
General Fund:					
Revenue anticipation notes.....	\$ -	\$ 700,000	\$ (700,000)	\$ -	\$ 1,000,000
Line-of-credit agreements.....	-	-	-	-	-
Subtotal - General Fund activity.....	-	700,000	(700,000)	-	1,000,000
Capital Projects Funds:					
Bond anticipation notes.....	75,100	365,000	(300,000)	140,100	-
Subtotal - Capital Projects Funds activity.....	75,100	365,000	(300,000)	140,100	-
Total short-term financing and credit agreement activity.....	<u>\$ 75,100</u>	<u>\$ 1,065,000</u>	<u>\$ (1,000,000)</u>	<u>\$ 140,100</u>	<u>\$ 1,000,000</u>

6. LONG-TERM DEBT

Under the Constitution of the Commonwealth of Massachusetts, the Commonwealth may borrow money (a) for defense, (b) in anticipation of receipts from taxes or other sources, any such loan to be paid out of the revenue of the year in which the loan is made, or (c) by a two-thirds vote of the members of each house of the Legislature present and voting thereon. The Constitution further provides that borrowed money shall not be expended for any other purpose than that for which it was borrowed or for the reduction or discharge of the principal of the loan. In addition, the Commonwealth may give, loan or pledge its credit to another entity by a two-thirds vote of the members of each house of the Legislature. The Legislature may not in any manner allow the Commonwealth credit to be given or loaned to or in aid of any individual, or of any private association, or of any corporation, which is privately owned or managed.

The Commonwealth has waived its sovereign immunity and consented to be sued on contractual obligations, including bonds and notes issued by it and all claims with respect thereto. However, the property of the Commonwealth is not subject to attachment or levy to pay a judgment, and the satisfaction of any judgment generally requires legislative appropriation. Enforcement of a claim for the payment of principal or interest on bonds and notes of the Commonwealth may also be subject to the provisions of federal or Commonwealth statutes, if any, enacted to extend the time for payment or impose other constraints upon enforcement.

As of June 30, 2005, the Commonwealth had three types of long-term debt outstanding, general obligation bonds, special obligation bonds and federal highway grant anticipation notes. The following is a summary of the Commonwealth's debt outstanding by type of debt (amounts in thousands):

	Amount Outstanding
<u>General Obligation Debt:</u>	
General Obligation Bonds:	
Fixed rate.....	\$ 11,841,879
Variable rate.....	2,199,795
Auction rate securities.....	401,500
College opportunity bonds.....	91,074
County debt assumed.....	600
Grant anticipation notes (inclusive of cross-over refunding notes).....	1,907,340
Discount / (Premium) and issuance cost, general obligations.....	<u>(33,762)</u>
Subtotal - General Obligation Debt.....	16,408,426
<u>Special Obligation Debt:</u>	
Special Obligation Bonds (inclusive of cross-over refunding bonds):	
Fixed rate.....	\$ 1,302,469
Variable rate.....	<u>183,080</u>
Subtotal - Special Obligation Debt.....	1,485,549
Discount / (Premium) and issuance cost, special obligations.....	<u>(37,176)</u>
Total Outstanding Debt.....	<u>\$ 17,856,799</u>

A. General Obligation Bonds

General Obligation Bonds are authorized and issued primarily to provide funds for Commonwealth-owned capital projects and Commonwealth supported local government improvements. They are backed by the full faith and credit of the Commonwealth and paid from the Governmental Funds, from which debt service principal and interest payments are appropriated. Massachusetts General Laws provide for the allocation of bond proceeds to these authorizations in arrears, as expenditures are made, unless the proceeds are allocated at the time of issuance.

In FY2005, the Commonwealth sold \$500,000,000 in General Obligation Bonds to partially capitalize the Massachusetts School Modernization and Reconstruction Trust (SMART). The proceeds of the debt (half of the total authorization of \$1 billion,) were used to fund school construction projects throughout the Commonwealth pursuant to changes in the funding of school building assistance initiated during the fiscal year.

In addition, forms of general obligation bonds are issued for specific programs approved by the Legislature. These are as follows:

i. College Opportunity Bonds

Some Commonwealth general obligation debt is issued in the form of College Opportunity Bonds (COBs) as authorized by the Massachusetts General Laws. These bonds are sold to fund the Commonwealth's "U. Plan" which is part of a college savings program administered by the Massachusetts Educational Financing Authority. These bonds are privately placed and are structured to meet the needs of investors in this plan. Such bonds were initially issued in fiscal year 1996, and have been issued in each subsequent fiscal year, including FY05, during which approximately \$11,990,000, (including accretion), of such bonds were issued. Outstanding COBs have maturity dates ranging from 2006 through 2025. COBs have an accreting interest component payable at maturity. The annual accretion rate of each COB's maturity is a variable rate equal to the annual change in the Consumer Price Index (CPI) plus 2.0%. Assuming the CPI averages 3.5% during the life of the outstanding COBs the payments due at maturities of the COBs will total approximately \$169,548,000, including accretion. In addition, COBs pay current interest in the amount of 0.5% per year of the initial amount still outstanding. The full faith and credit of the Commonwealth back these bonds.

ii. County Debt Assumed

Chapter 38 of the Acts of 1997 and Chapter 300 of the Acts of 1998 abolished governments of several Massachusetts counties on various effective dates. As part of these provisions, the Commonwealth assumed the outstanding debt of Middlesex County on July 1, 1997, of Hampden and Worcester Counties on July 1, 1998, that of Essex County on July 1, 1999 and that of Berkshire County on July 1, 2000. The county debt assumed has become general obligation debt of the Commonwealth. As of June 30, 2005, \$600,000 of these obligations remain outstanding.

**iii. Variable Rate Demand
Bonds**

Included in the long-term debt is \$2,199,795,000 of general obligation variable rate demand bonds (VRDBs) maturing from 2008 through 2030 in varying amounts, of which \$1,924,205,000 is swapped to fixed rates. The redemption schedule for these bonds is included in the bond redemption schedule contained herein. The interest rate on the VRDBs is determined either weekly or daily based on the activity of the Commonwealth's remarketing agents, and interest is paid monthly. On any reset date, holders of the VRDBs can require the Commonwealth (acting through its remarketing and tender agents) to repurchase the bonds (a "put"). The remarketing agent is authorized to use its best efforts to resell any repurchased bonds by adjusting the interest rates offered. The Commonwealth pays an annual fee to the remarketing agents equal to 0.05% of the outstanding par amount of the bonds.

Under the provisions of stand-by bond-purchase agreements entered into by the Commonwealth with certain commercial banks, the remarketing and tender agents are entitled to draw amounts sufficient to pay the purchase price of any bonds that cannot be resold. During any such period, the Commonwealth is required to pay the bank(s) at an interest rate based on their respective prime lending rates. If the remarketing agent is unable to resell any put bonds within six months of the put date, the stand-by bond-purchase agreements include provisions to convert any such bonds to installment loans payable over an extended period of time, with interest payable at a rate based on the bank(s) prime lending rate(s). The stand-by bond-purchase agreements expire on various dates between September of 2005 and December 2015. The Commonwealth is required to renew or replace these agreements as long as the VRDBs remain outstanding. The Commonwealth currently pays an annual fee to maintain these agreements, which range from 0.12% to 0.22% of the par amount of the bonds.

**iv Other Variable Rate
Bonds**

As part of its refunding activities during FY03, the Commonwealth issued \$97,455,000 of refunding bonds which pay a variable rate interest that depends on changes in the Consumer Price Index (CPI). These bonds, which pay interest every six months, are not subject to periodic remarketing, nor do bondholders have the right to "put" such bonds back to the Commonwealth.

On June 29, 2004 as part of the Commonwealth's issuance of the Convention and Exhibition Center Special Obligation Bonds, \$86,590,000 of such bonds were issued paying a variable rate of interest also indexed to changes in the CPI. Similar to the 2003 Bonds, the Convention Center Bonds pay interest semiannually, but mature serially from FY15 to FY18.

As detailed in the variable rate debt schedule, these CPI based bonds all have been swapped to fixed rates ranging from 4.45% to 5.25%.

**v Auction Rate
Securities**

Also included in the long-term debt is \$401,500,000 of General Obligation Auction Rate Securities (ARS) maturing in varying amounts from 2020 through 2030. The interest rate payable on the bonds changes weekly as determined pursuant to specified auction procedures. Interest on the bonds is payable weekly. In the case of a failed auction (i.e., insufficient bids to clear the market) existing buyers may be required to hold their bonds with interest payable at a rate equal to a percentage of an ARS industry index, up to a maximum rate of 12.0%.

B. Special Obligation Bonds

The Commonwealth also issues special obligation revenue bonds as authorized by Massachusetts General Laws. Such bonds may be secured by all or a portion of revenues credited to the Highway Fund and are not general obligations of the Commonwealth. At June 30, 2005, the Commonwealth had outstanding \$1,458,375,000 of such special obligation bonds, inclusive of unamortized premium, of which \$1,448,372,000 is allocated to debt not subject to the Commonwealth's statutory debt limit. These bonds are secured by a pledge of 6.86 cents of the 21 cent motor fuel excise tax imposed on gasoline.

In March of 2005, the Commonwealth sold \$216,765,000 of special obligation revenue bonds, Series 2005A. The bonds generated \$25,705,000 of premium. Of the proceeds, \$216,725,000 was issued to refund prior special obligation bonds, including \$73,495,000 of bonds pursuant to a crossover refunding. The remainder was used to fund capital spending in the Commonwealth. The escrow funded by the refunding bonds and related premium will be used only to secure the principal related to the crossover refunding portion (as well as exclusive of related call premiums.) These particular bonds will mature on June 1, 2008. The interest related to these maturities is not secured by this escrow. Rather, it will be paid from the existing stream of motor fuel excise taxes. Interest on a portion of the newly issued refunding bonds will be paid from the proceeds of the escrow until the aforementioned prior bonds are called for redemption. This crossover refunding results in economic savings to the Commonwealth similar to a normal refunding, but does not meet the accounting definition of defeasance of debt, in which case the defeased debt and the related escrow accounts would have been removed. Until such time as the escrow is used to repay the principal of the refunded bonds, such amounts will be reported in the Highway Capital Projects Fund. Additional special obligation refunding bonds that were the result of crossover refundings, were sold during FY2002. As of June 30, 2005, \$389,425,000 from both cross over refundings remained outstanding.

The remainder of unrefunded special obligation debt is attributable to the aforementioned gasoline tax bonds and other bonds that permanently financed the Commonwealth's convention and exhibition centers in Boston, Springfield and Worcester, which are secured by certain taxes collected related to those facilities.

**C. Federal Highway Grant
Anticipation Notes**

The Commonwealth also issued Federal Highway GANs to finance current cash flow for the Central Artery/Tunnel Project in anticipation of future federal reimbursements. Section 9 through 10D of Chapter 11 of the Acts of 1997, as amended by Chapter 121 of the Acts of 1998, authorizes the Commonwealth to sell up to \$1,500,000,000 in GANs. Prior to FY2005, all GANs authorized were issued. All Federal Highway Construction reimbursements and reimbursements from the federal highway construction trust funds are pledged to the repayment of the GANs. These notes are secured by the pledge of Federal Highway Construction Reimbursements without a general obligation pledge. Under certain limited circumstances, a portion of the revenue from the Commonwealth's motor fuels excise tax may be used to pay debt service on the GANs.

In July of 2004, the Commonwealth sold \$408,015,000 of GANs refunding notes, Series 2003A. These notes are Special Obligations of the Commonwealth. The escrow funded by the notes will be used to secure the principal related to \$418,340,000 of GANs, including related call premiums, in previously issued series callable on December 15, 2008 and 2010. The interest related to these maturities is not secured by this escrow. Rather, it will be paid from Commonwealth appropriations or the existing stream of future federal grants. Interest on the newly issued refunding notes will be paid from the proceeds of the escrow until the aforementioned prior notes are called for redemption. For the purposes of the pledge but not for accounting purposes, at the time of call, the refunding notes will become GANs. This results in economic savings to the Commonwealth similar to a normal refunding, but does not meet the accounting definition of defeasance of debt, in which case the defeased debt and the related escrow accounts would have been removed. Until such time as the escrow is issued to repay the principal of the refunded notes, such amounts will be reported in the Grant Anticipation Note Trust Fund. Inclusive of the cross-over refunding notes, at June 30, 2004, the Commonwealth has \$1,907,340,000 of GANs outstanding, including accreted interest on capital appreciation bonds with maturity dates ranging from 2006 to 2015.

**D. Interest Rate Swap
Agreements**

The Commonwealth enters into interest rate swap agreements to modify interest rates on outstanding debt. Other than the net interest expenditures resulting from these agreements, no amounts are recorded in the financial statements.

Objective of the Interest Rate Swap Agreements

In connection with the issuance of variable rate refunding bonds in 1997, 1998, 2001, 2003 and 2005, the Commonwealth entered into interest rate swap agreements with certain counterparties. Additional swap agreements were initiated as part of the Convention centers permanent financing in FY2004. The purpose of these agreements is to effectively fix the interest rate payable on the corresponding variable rate refunding bonds, and to achieve an all-in synthetic interest rate that is lower than the rate that could have been achieved on a natural fixed rate basis at the time the agreements were entered into.

Terms of the Interest Rate Swap Agreements

The bonds and related swap agreements have final maturities ranging from 2005 to 2028. The swaps' total notional value of \$2,107,285,000 matches the par amount of the related variable rate refunding bonds. Under the swap agreements, the Commonwealth pays the relevant counterparties' fixed rates ranging from 2.56% to 5.25% and receives variable rate payments equal to the amount of variable rate payments the Commonwealth pays on the related variable rate refunding bonds.

The following chart details the Commonwealth's outstanding swaps and related bond issuances:

Associated Bond Issue	Notional Amounts (thousands)	Effective Date	Fixed Rate Paid (Range)	Variable Rate Received	Fair Market Values (thousands)	Final Termination Date	Counterparty Credit Rating
<i>General Obligation Bonds:</i>							
Series 1997B	\$ 162,768	8/12/1997	4.659%	Cost of Funds	\$ (15,634)	August 1, 2015	AA+/Aaa
Series 1997B	108,512	8/12/1997	4.659%	Cost of Funds	(11,653)	August 1, 2015	AAA/Aaa
Series 1998A & B	299,712	9/17/1998	4.174%	Cost of Funds	(25,297)	September 1, 2016	AAA/Aaa
Series 1998A & B	199,808	9/17/1998	4.174%	Cost of Funds	(13,586)	September 1, 2016	AAA/Aaa
Series 2001B & C	496,225	2/20/2001	4.150%	Cost of Funds	(61,394)	January 1, 2021	AAA/Aaa
Series 2003B	87,455	3/12/2003	4.500%	Cost of Funds/CPI	(303)	March 1, 2014	AA+/Aaa
Series 2003B	10,000	3/12/2003	4.500%	Cost of Funds/CPI	42	March 1, 2013	A/A2
Series 2005A	559,725	3/29/2005	2.22% - 4.00%	BMA	(13,479)	February 1, 2028	AA-/Aa2
Subtotal	<u>1,924,205</u>				<u>\$ (141,304)</u>		
<i>Special Obligation Dedicated Tax Revenue Bonds (CPI Based Swaps):</i>							
Series 2004	28,863	6/29/2004	4.45% - 5.25%	Cost of Funds/CPI	2,226	January 1, 2018	A/A1
Series 2004	28,863	6/29/2004	4.45% - 5.25%	Cost of Funds/CPI	(2,305)	January 1, 2018	A+/Aa3
Series 2004	28,863	6/29/2004	4.45% - 5.25%	Cost of Funds/CPI	(2,401)	January 1, 2018	AA-/Aa2
Series 2005A	<u>96,490</u>	6/12/2005	4.78% - 5.06%	Cost of Funds/CPI	<u>(5,736)</u>	June 1, 2022	AA-/Aa3
Subtotal	<u>183,080</u>				<u>\$ (8,216)</u>		
Total	\$ 2,107,285				\$ (149,520)		

Fair Market Value of the Interest Rate Swap Agreements

Swap rates for the types and remaining terms of the Commonwealth's swap agreements are generally lower (as of June 30, 2005) than those that prevailed when the various swap contracts were entered into. This is the result of two factors: (1) lower interest rates in general; and (2) the shortening of the remaining terms of the swap contracts due to the passage of time and an upward sloping yield curve for such instruments. As a result, the Commonwealth's swap agreements have an estimated fair market value of negative \$149,520,000 as of June 30, 2005. If all the Commonwealth's swap agreements had been terminated as of the end of fiscal year 2005 the Commonwealth would have been required to make a payment of this magnitude. Although the Commonwealth has the option of terminating its swap agreements at any time (and either make or receive any termination payment due), the Commonwealth's counterparties do not have such an option. Therefore, the Commonwealth would only have to make a payment of the magnitude estimated if certain termination events occurred, as described below.

Credit Risk of the Interest Rate Swap Agreements

The swap contracts require that the Commonwealth's counterparties maintain certain ratings levels. If they fail to maintain such ratings, the Commonwealth could choose to terminate the related swap agreement and receive or pay a termination payment depending on the interest rates at the time. Similarly, the Commonwealth is required to maintain a certain credit rating under the agreements, generally in the "A" category. If the Commonwealth's rating fell below those levels, the Commonwealth's counterparties could choose to make variable rate payments based on a market index (instead of the actual bond rate) which would subject the Commonwealth to basis risk, as noted below.

Basis, Market and Rollover Risk of the Interest Rate Swap Agreements

Because the terms on the interest rate swap agreements require the Commonwealth's counterparties to make variable rate payments equal to those the Commonwealth makes on the related variable rate bonds, the Commonwealth is not generally subject to any basis or market risk as a result of these agreements. Under certain circumstances, such as a downgrade of the credit rating of the bonds or the enactment of tax-related legislation which causes the related bonds to trade differently, the swap agreements provide that the Commonwealth's counterparties, may, at their option, pay a variable rate that is based on one or more market indices such as LIBOR or the BMA swap index. Under these circumstances, the Commonwealth would be subject to basis risk if these indices varied significantly from the variable rates that were determined for the Commonwealth's variable rate demand bonds through the associated remarketing process.

The swap contracts have the same maturity dates and amortizations as the related bonds. Therefore, the Commonwealth is not subject to any rollover risk as a result of these agreements.

Termination Risk of the Interest Rate Swap Agreements

The swap contracts use the International Swap Dealers Association Master Agreement, which includes standard termination events, such as failure to pay and bankruptcy. The swap agreements are not otherwise subject to termination except at the Commonwealth's option. If one or more of the swap agreements were terminated, then related variable rate bonds would no longer be hedged and the Commonwealth would no longer be paying a synthetic fixed rate with respect to the bonds. In addition, if at the time of termination, the swap had a negative fair value, the Commonwealth would incur a loss and would be required to settle with the related counterparty or counterparties at the swaps' fair market values.

Interest Rate Swap Agreement Dispute

The Commonwealth is party to an interest rate swap agreement relating to the Commonwealth's General Obligation Bonds, 2001 Series B and 2001 Series C. The swap documentation provides that the method for determining the floating rate obligation of the counterparty may change upon an "Event of Taxability". The swap counterparty has asserted that an Event of Taxability has occurred and that, as a result, commencing May 3, 2004, the Commonwealth's monthly net payments to the counterparty must be increased. The Commonwealth disagrees with this assertion and, on April 23, 2004, filed a complaint in Suffolk County Superior Court. The swap payment made by the Commonwealth on May 3, 2004 and each monthly payment made thereafter have been calculated based on the pre-existing method. Had they been calculated as asserted by the swap counterparty, under marked conditions on each such payment date through June 1, 2005, the payments would have been approximately \$1.7 million greater in the aggregate. The termination value of this swap as of June 30, 2005 is believed to have been approximately \$61.4 million in favor of the swap counterparty and will vary from time to time. The Commonwealth has continued to make net swap payments based on its actual variable rate bond payments pending legal developments.

Debt service on the variable rate bonds is as follows (assuming a short term rate of 2.75% and a CPI rate of 3%) (amounts in thousands):

Fiscal Year Ending June 30	Variable-Rate Bonds		Interest Rate		Total
	Principal	Interest	Swaps, Net		
2006	\$ 3,245	\$ 58,622	\$ 30,231	\$	92,098
2007	3,745	58,528	30,235		92,508
2008	6,190	58,376	30,207		94,773
2009	12,030	58,135	30,145		100,310
2010	34,545	57,292	29,784		121,621
2011-2015	722,010	243,062	124,284		1,089,356
2016-2020	817,915	119,305	56,807		994,027
2021-2025	408,650	38,357	17,220		464,227
2026-2031	98,955	4,487	2,016		105,458
Total	<u>\$ 2,107,285</u>	<u>\$ 696,164</u>	<u>\$ 350,929</u>	<u>\$</u>	<u>3,154,378</u>

E. Outstanding Debt

For financial reporting purposes, long-term debt is carried at its face value, which includes discount and any issuance costs. The outstanding amount represents the total principal to be repaid. For capital appreciation bonds, the outstanding amount represents total principal and accreted interest to be repaid. When short-term debt has been refinanced on a long-term basis, it is reported as outstanding at its face amount.

The amount of long-term debt authorized but unissued is measured in accordance with the statutory basis of accounting. Only the net proceeds (exclusive of discount and costs of issuance) are deducted from the total authorized by the Legislature.

Long-term debt outstanding (including unamortized discount and issuance cost) and debt authorized and unissued at June 30, 2005 is as follows (amounts in thousands):

Purpose	Bonds Outstanding	Fiscal Year Maturities	Authorized and Unissued
GANs.....	\$ 1,907,340	2006-2015	\$ -
Capital Projects:			
General.....	6,004,267	2005-2031	4,903,055
Highway.....	8,837,377	2005-2034	3,907,063
Local Aid.....	1,049,668	2005-2031	593,693
Other.....	58,146	2005-2029	103,010
	<u>15,949,459</u>		<u>9,506,821</u>
Total.....	<u>\$ 17,856,799</u>		<u>\$ 9,506,821</u>

Interest rates on the Commonwealth's debt outstanding at the end of FY05 ranged from 0.0% to 8.0%.

Changes in long-term debt outstanding (including discount and issuance cost) and bonds authorized - unissued for the year ended June 30, 2005 are as follows (amounts in thousands):

	Bonds Outstanding	Authorized and Unissued
Balance July 1, 2004.....	\$ 17,382,172	\$ 6,827,993
General and special obligation bonds:		
Principal, less discount and issuance costs.....	1,354,226	(1,354,226)
Net premium and issuance costs.....	(86,945)	-
General and Special obligation refunding bonds:		
Principal on Refunding Bonds.....	1,296,532	-
Principal on Refunded Bonds.....	(1,230,673)	-
Retired premium on Refunded Bonds.....	23,753	-
Increase in bonds authorized.....	-	4,041,138
Decrease in bonds authorized.....		(8,084)
Bonds retired.....	(882,266)	-
Balance June 30, 2005.....	<u>\$ 17,856,799</u>	<u>\$ 9,506,821</u>

At June 30, 2005, debt service requirements to maturity for principal (including unamortized discount, capital appreciation and issuance costs) and interest including all variable rate interest not hedged by swap agreements (assumed interest rate is 5%) are as follows (amounts in thousands):

Fiscal Year Ended June 30,	Principal	Interest	Total
2006.....	\$ 1,024,522	\$ 886,927	\$ 1,911,449
2007.....	1,072,597	840,831	1,913,428
2008.....	1,097,010	785,623	1,882,633
2009.....	1,105,235	729,723	1,834,958
2010.....	1,051,320	673,298	1,724,618
2011-2015.....	5,283,141	2,549,006	7,832,147
2016-2020.....	3,404,067	1,393,035	4,797,102
2021-2025.....	2,507,867	599,824	3,107,691
2026-2030.....	916,560	240,054	1,156,614
2031-2033.....	394,480	31,617	426,097
Total	<u>\$ 17,856,799</u>	<u>\$ 8,729,938</u>	<u>\$ 26,586,737</u>

The Commonwealth issued bonds and notes through both competitive and negotiated sales during FY05. The costs for legal counsel and underwriting fees for bond sales were \$470,000 and \$10,209,000 respectively. In addition, the Commonwealth paid \$176,000 for disclosure counsel services.

F. Bonds Defeased Through Refunding during FY05

As authorized by the Massachusetts General Laws, the Commonwealth advance refunded certain general and special obligation bonds through the issuance of \$1,395,377,000 of general and special obligation refunding bonds, inclusive of premiums, during FY05. Net proceeds after issuance costs totaled approximately \$1,377,083,000 were used to purchase U.S. Government and U.S. Government Agency securities, which were deposited in irrevocable trusts with an escrow agent to provide for all future debt service payments of the refunded bonds. As a result, with the exception of the aforementioned crossover refunding bonds, the refunded bonds are considered to be defeased, and the liabilities therefore have been removed from the General Long-term Obligations Account Group. As a result of these refundings, the Commonwealth decreased current year debt service payments and has taken advantage of lower interest rates, and it has decreased its aggregate debt service payments by approximately \$112,274,000 over the next 23 years and will experience an economic gain (the difference between the present values of the debt service payments of the refunded and refunding bonds) of approximately \$67,273,000. At June 30, 2005, approximately \$1,286,720,000 of the bonds defeased and refunded during FY2005 remain outstanding.

G. Prior Defeasance

In prior years, the Commonwealth defeased certain general and special obligation bonds by purchasing securities (from the proceeds of refunding bonds or from surplus operating funds) and placing them in irrevocable trusts to provide for all future debt service payments on the defeased bonds. Accordingly, exclusive of the aforementioned crossover refunding, the trust account assets and the liabilities for the defeased bonds are not included in the financial statements. At June 30, 2005, approximately \$5,264,035,000 of bonds outstanding from activities in prior fiscal years are considered defeased.

H. Statutory Debt Limit

The Massachusetts General Laws establish limits on the amount of direct debt outstanding. By statutorily limiting the Commonwealth's ability to issue direct debt, this limit provides a control on annual capital spending. The direct debt limit for FY05 was approximately \$13,463,535,000. Outstanding debt subject to the limit at June 30, 2005 was approximately \$12,185,286,000. The limit increases 5% per year.

For purposes of determining compliance with the limit, outstanding direct debt is defined by statute to include general obligation bonds at the amount of their original net proceeds. It excludes BANs, discount and issuance costs, if any, special obligation bonds, GANs, refunded bonds, certain refunding bonds, debt issued by counties, debt issued in conjunction with the MBTA Forward Funding, certain Central Artery / Tunnel debt and debt issued for the SMART program. The amounts excluded from the debt limit are as follows (amounts in thousands):

	Debt Outstanding
Balance June 30, 2005.....	\$ 17,856,799
Less amounts excluded:	
Premium and issuance cost.....	70,937
Special Obligation principal.....	(1,485,548)
GANs principal.....	(1,908,015)
County Debt Assumed.....	(600)
MBTA Forward Funding.....	(511,546)
SMART bonds.....	(500,000)
Central Artery / Tunnel.....	(1,336,741)
Outstanding direct debt.....	<u>\$ 12,185,286</u>

I. Subsequent Bond Issuances

In July of 2005, the Commonwealth sold \$527,635,000 in Special Obligation Revenue Refunding Bonds. The proceeds were used to refund the majority of the Convention and Exhibition Center Special Obligation Bonds sold during FY2004.

In August of 2005, the Commonwealth sold \$400,000,000 of General Obligation Bonds, 2005 Series B. The proceeds were used to fund capital spending.

Also in August of 2005, the Commonwealth issued an additional series of College Opportunity Bonds totaling \$11,581,000. This includes an initial amount of \$7,078,000 plus an expected \$4,503,000 in interest to be accreted through maturity.

In October of 2005, the Commonwealth sold \$701,895,000 of General Obligation Bonds, 2005 Series C and \$60,000,000 of 2005 Series D (Federally taxable bonds.) The proceeds were used to fund capital spending.

7. LEASES

In order to finance the acquisition of equipment, the Commonwealth has entered into various lease / purchase agreements, including tax-exempt lease purchase (TELP) agreements, which are accounted for as capital leases. Lease agreements are for various terms and contain clauses indicating that their continuation is subject to appropriation by the Legislature. For the fiscal year ended June 30, 2005, capital lease / purchase expenditures totaled approximately \$30,205,000.

At June 30, 2005, the Commonwealth's aggregate outstanding liability under capital leases, based on the present value of the net minimum lease payments, totaled approximately \$173,331,000. This liability is reported in the General Long-Term Obligations Account Group. Equipment acquired under capital leases and included in the General Fixed Assets Account Group totaled approximately \$95,713,000.

The Commonwealth has numerous operating lease agreements for real property and equipment with varying terms. These agreements contain provisions indicating that continuation is subject to appropriation by the Legislature.

Certain colleges have capital leases for energy projects with guaranteed energy savings. The result of these savings yields zero interest due from 2014 – 2022 on these leases.

Operating lease expenditures for the fiscal year ended June 30, 2005 were approximately \$192,683,000.

The following is a schedule of future minimum payments under non-cancelable leases as of June 30, 2005 (amounts in thousands):

	Capital Leases		Operating	
	<u>Principal</u>	<u>Interest</u>	<u>Leases</u>	<u>Total</u>
2006.....	\$ 40,794	\$ 7,207	\$ 159,127	\$ 207,128
2007.....	33,017	5,477	108,094	146,588
2008.....	30,393	4,485	78,671	113,549
2009.....	16,347	2,618	60,209	79,174
2010.....	16,596	2,122	41,511	60,229
2011-2015.....	31,894	2,914	215,058	249,866
2016-2020.....	2,228	338	41,414	43,980
2021-2025.....	2,062	312	46,732	49,106
2026-2029.....	-	-	37,386	37,386
Total.....	<u>\$ 173,331</u>	<u>\$ 25,473</u>	<u>\$ 788,202</u>	<u>\$ 987,006</u>

8. INDIVIDUAL FUND DEFICITS

In order to resolve the deficits in the budgeted funds, the Comptroller has recommended authorization of transfers from other budgeted funds with surplus balances or a plan of fund consolidation. For the Non-Budgeted Special Revenue Funds, the Comptroller has recommended similar budgeted transfers to subsidize and resolve the deficits or consolidation of such funds into budgeted funds. In both cases, such steps require legislative action.

The Capital Projects Fund deficit reported in the following table reflects the time lag between capital expenditures and the sale of related bonds. To arrive at the combined capital projects fund balance, this individual fund deficit of \$531,291,000 is offset by capital funds earmarked in the Central Artery Statewide Road and Bridge Infrastructure Fund of \$334,448,000 along with \$363,971,000 held in escrow for the two crossover refunding Special Obligation Bonds series' and \$26,218,000 in reserve for the other Capital Projects Funds.

The General Capital Projects Fund deficit is inclusive of SMART expenditures for school construction in the Commonwealth. \$500 million of expenditures occurred in FY2005 for school construction with the remainder of the \$1 billion authorization expected to occur in FY2006.

The following Budgeted, Non-Budgeted Special Revenue and Capital Projects Funds are included in the combined totals and have individual fund deficits at June 30, 2005, as follows (amounts in thousands):

Budgeted Funds:	
Highway Fund.....	\$ (824,236)
Children's and Seniors' Health Care Assistance Fund.....	(245,914)
Total Budgeted Funds.....	<u>(1,070,150)</u>
Non-Budgeted Special Revenue:	
Other:	
Government Land Bank Fund.....	(35,097)
Motor Vehicle Safety Inspection Trust Fund.....	(21,311)
Total Non - Budgeted Funds.....	<u>(56,408)</u>
Capital Projects:	
General Capital Projects Fund.....	(531,291)
Capital Investment Trust Fund.....	(757)
Capital Improvements and Investment Trust Fund.....	(12,524)
Capital Expenditure Reserve Fund.....	(98,829)
Government Land Bank Capital Project Fund.....	(10,000)
Local Capital Projects Fund.....	(16,345)
Total Capital Projects Funds.....	<u>(669,746)</u>
Total	<u>\$ (1,796,304)</u>

9. MEDICAID COSTS

The Commonwealth provides medical care for low-income, elderly and other residents who qualify for such assistance under the federally-sponsored Medical Assistance Program (Medicaid). The Commonwealth pays the full cost of care and is reimbursed by the federal government for 50 percent of that cost. For the fiscal year ended June 30, 2005, the General Fund, and Children's and Seniors' Health Fund include \$5,977,221,000 in expenditures for Medicaid claims processed for payment. An additional \$291,623,000 of Medicaid expenditures were reported in the non-budgeted special revenue fund, the Health Care Quality Improvement Fund.

The combined financial statements – statutory basis include Medicaid claims processed but unpaid at June 30, 2005 of approximately \$127,929,000 as accounts payable. The Commonwealth estimates its total liability, as determined in accordance with GAAP, at \$693,100,000 including the amounts reported as accounts payable at June 30, 2005. This amount includes estimates of both the cost of care provided as of June 30, 2005, for which claims have not been processed and other costs. Of this amount, \$359,685,000 is expected to be reimbursed by the federal government and third party recoveries.

10. RETIREMENT SYSTEMS

A. Primary Government

The Commonwealth is statutorily responsible for the pension benefits for Commonwealth employees (members of the State Employees' Retirement System) and for teachers of the cities, towns, regional school districts throughout the Commonwealth and Quincy College (members of the Teachers' Retirement System, except for teachers in the Boston public schools, who are members of the State-Boston Retirement System but whose pensions are also the responsibility of the Commonwealth). The members of the retirement systems do not participate in the Social Security System.

The Commonwealth has assumed responsibility for payment of cost-of-living adjustments (COLA) for the separate (non-teacher) retirement systems of its cities, towns and counties, granted in fiscal year 1981 to 1996. The Commonwealth performs this valuation on an annual basis.

B. Plan Descriptions

The *State Employees' Retirement System* (SERS) is a single employer defined benefit public employee retirement system (PERS), covering substantially all employees of the Commonwealth and certain employees of the independent authorities and agencies, including the state police officers at the Massachusetts Port Authority and the Massachusetts Turnpike Authority. The SERS is administered by the Commonwealth and is part of the reporting entity and does not issue a stand alone financial report.

The *Teachers' Retirement System* (TRS) is an agent multiple employer defined benefit PERS. The Commonwealth is a non-employer contributor and is responsible for all contributions and future benefit requirements of the TRS. The TRS covers certified teachers in cities (except the City of Boston), towns, regional school districts and Quincy College. The TRS is administered by the Commonwealth and is part of the reporting entity and does not issue a stand-alone financial report.

The *State – Boston Retirement System* (SBRS) is a hybrid multiple employer defined benefit PERS. SBRS provides pension benefits to all full-time employees upon commencement of employment with any of the various government agencies covered by SBRS. The Commonwealth is a non-employer contributor and is only responsible for the actual cost of pension benefits for SBRS participants who serve in the City of Boston's School Department in a teaching capacity (BTRS). The cost of pension benefits of the other participants is the responsibility of the City of Boston. SBRS is not administered by the Commonwealth and is not part of the reporting entity and a stand-alone financial report is not available.

Certain Commonwealth employees and current retirees employed prior to the establishment of the State Employees' Retirement System are covered on a "pay-as-you-go" basis. During the year ended June 30, 2005, the Commonwealth's pension expenditure included payments totaling \$11,631,000 to current retirees employed prior to the establishment of the current plans and the non-contributory plans.

The policy for post-retirement benefit increases for all retirees of the SERS, TRS, BTRS and COLA of local governments is subject to legislative approval.

Membership – Membership in SERS, TRS and BTRS as of January 1, 2005, the date of the most recent valuation, is as follows:

	<u>SERS</u>	<u>TRS</u>	<u>BTRS</u>
Retirees and beneficiaries			
currently receiving benefits.....	50,907	42,164	3,155
Terminated employees entitled to benefits but not yet receiving them....	3,033	N/A	183
Subtotal.....	53,940	42,164	3,338
Current employees:			
Vested*.....	41,432	44,021	3,218
Non-vested*.....	40,250	44,006	2,562
Subtotal.....	81,682	88,027	5,780
Total.....	135,622	130,191	9,118

* Estimated

C. *Benefit Provisions*

Massachusetts General Laws establish uniform benefit and contribution requirements for all contributory PERS. These requirements provide for retirement allowance benefits up to a maximum of 80% of a member's highest three-year average annual rate of regular compensation. Benefit payments are based upon a member's age, length of creditable service, and group creditable service, and group classification. The authority for amending these provisions is with the Legislature.

Members become vested after ten years of creditable service. A superannuation retirement allowance may be received upon the completion of twenty years of service or upon reaching the age of 55 with ten years of service. Normal retirement for most employees occurs at age 65; for certain hazardous duty and public safety positions, normal retirement is at age 55.

D. *Funding Progress*

During FY01, the Legislature passed Chapter 114 of the Acts of 2000, which modified Chapter 32 of the General Laws. This modification became effective on July 1, 2001. In Chapter 114, teachers who are members of the State Teachers Retirement System, or teachers who are members of the State – Boston Retirement System before 1975, who resigned or took an unpaid leave of absence because of maternity leave will be allowed to “buy back” into the fund up to a maximum of four years. The member must pay the amount determined by the Retirement Board by December 31, 2001 to qualify, as long as the member has worked longer than ten years. If the member completes ten years of service after December 31, 2001, payment can be made within 18 months of completion of ten years of service. In addition, the law creates a superannuation retirement benefit program for all teachers hired on or after July 1, 2001. This program has a contribution rate of 11 percent of regular compensation. To be eligible for the alternative benefit at retirement, the teacher must have completed thirty years of eligible service. All previous members may elect to participate in the program, as long as they participate with the equivalent of a minimum of five years of employee contributions at the new rate. If the member retires before five years, the teacher must pay into the system, the amount that would have been paid in one lump sum, or in installments as the Board may prescribe. The alternative benefit is calculated as the percentage of average compensation determined under the current formula increased by 2% of the average annual compensation for each full year of service in excess of 24 years. The election to participate is irrevocable.

The following table presents the schedule of funding progress as presented in the most recent actuarial valuations at the dates indicated (amounts in thousands):

Actuarial Valuation as of January 1	Actuarial Value of Plan Assets	Actuarial Accrued Liability	Unfunded Actuarial Liability (UAL)	Funded Ratio %	Annual Covered Payroll *	UAL as a % of Covered Payroll
State Employees' Retirement System						
2005	\$ 16,211,000	\$ 19,575,000	\$ 3,364,000	82.8 %	\$ 3,967,000	84.8 %
2004	15,931,000	18,966,000	3,065,000	84.0	3,842,000	79.8 %
2003	13,947,000	17,551,000	3,604,000	79.5	3,779,000	95.4
2002	15,002,000	15,961,000	959,000	94.0	4,034,000	23.8
2001	13,922,000	15,170,000	1,248,000	91.8	3,700,000	33.7
2000	13,364,000	14,138,000	773,000	94.5	3,472,000	22.3
1998	9,914,000	11,361,000	1,447,000	87.3	3,111,000	46.5
1996	7,366,000	9,441,000	2,075,000	78.0	2,989,000	69.4
1995	5,879,000	8,602,000	2,723,000	68.3	2,992,000	91.0
1993	5,071,000	8,738,000	3,667,000	58.0	2,919,000	125.6
Teachers' Retirement System						
2005	17,683,000	26,167,000	8,483,000	67.6	4,643,000	182.7
2004	17,075,000	24,519,000	7,444,000	69.6	4,556,000	163.4
2003	14,762,000	22,892,000	8,129,000	64.5	4,406,000	184.5
2002	15,712,000	20,620,000	4,908,000	76.2	4,264,000	115.1
2001	14,390,000	18,170,000	3,779,000	79.2	4,072,000	92.8
2000	13,681,000	16,420,000	2,739,000	83.3	3,704,000	73.9
1998	10,170,000	13,095,000	2,925,000	77.7	3,175,000	92.1
1996	7,553,000	10,252,000	2,699,000	73.7	2,810,000	96.0
1995	6,014,000	9,712,000	3,698,000	61.9	2,667,000	138.7
1993	5,142,000	8,921,000	3,779,000	57.6	2,428,000	155.6
State - Boston Retirement System (Boston Teachers)						
2005	1,044,000	2,141,000	1,097,000	48.8	379,000	289.4
2004	1,040,000	2,022,000	982,000	51.4	368,000	266.8
2003	919,000	1,918,000	998,000	47.9	387,000	257.9
2002	984,000	1,756,000	772,000	56.0	370,000	208.6
2001	918,000	1,502,000	583,000	61.1	304,000	191.8
2000	860,000	1,381,000	521,000	62.3	285,000	182.8
1998	699,000	1,219,000	520,000	57.3	285,000	182.5
1996	549,000	1,025,000	476,000	53.6	274,000	173.7
1995	438,000	833,000	395,000	52.6	232,000	170.3
1993	370,000	743,000	373,000	49.8	206,000	181.1

* - The covered payroll amounts approximate the employer payroll.

E. Pension Actuarial Valuation

The Commonwealth's pension actuarial valuation was performed as of January 1, 2005 pursuant to Chapter 32 of the General Laws of the Commonwealth of Massachusetts and based on the plan provisions at that time. The following are the most significant assumptions used in preparing the 2005 actuarial valuation:

Investment return.....	8.25% per year
Interest rate credited to annuity savings.....	3.5% per year
Cost of living increases.....	3% per year
Mortality.....	RP-2000 Health Annuitant table projected with scale AA (gender distinct). This is applicable to both pre-retirement and post-retirement benefits. Adjustments made for disabled members and certain other groups.
Salary Increases.....	Based on analysis of past experience - ranges from 4.75% to 8.5% for groups 1 and 2, 5.5% to 9.5% for group 3, 5.5% to 12% for group 4 and 4.75% to 9.5% for teachers.

**F. Contributions Required
and Contributions Made**

The total contributions required for SERS, TRS and SBRS are based on the entry age normal cost method using the same actuarial assumptions used to compute the net pension obligation.

The Commonwealth was financially responsible for the COLA granted to participants in various retirement systems of cities, towns and counties in fiscal year 1981 to 1996. Chapter 17 of the Acts of 1997 effective for fiscal year 1998 transferred the responsibility for funding COLAs for separate (non-teacher) retirement systems of cities and towns to the respective system. Any future COLA granted by the Legislature to employees of these plans will be the responsibility of the individual system. The individual employer governments are also responsible for the basic pension benefits. The retirement systems are not administered by the Commonwealth and are not part of the reporting entity. The actuarial accrued liability for COLA as of January 1, 2005 was \$475,000,000.

The retirement systems' funding policies have been established by Chapter 32 of the Massachusetts General Laws. The Legislature has the authority to amend these policies. The annuity portion of the SERS, TRS and BTRS retirement allowance is funded by employees, who contribute a percentage of their regular compensation. Costs of administering the plan are funded out of plan assets.

Member contributions vary depending on the most recent date of membership:

<u>Hire Date</u>	<u>% of Compensation</u>
Prior to 1975.....	5% of regular compensation
1975 - 1983.....	7% of regular compensation
1984 to 6/30/1996.....	8% of regular compensation
7/1/1996 to present.....	9% of regular compensation except for State Police which is 12% of regular compensation
7/1/2001 to present.....	11% of regular compensation (for teachers hired after 7/1/01 and those accepting provisions of Chapter 114 of the Acts of 2000)
1979 to present.....	An additional 2% of regular compensation in excess of \$30,000

The Commonwealth's contribution for the pension benefit portion of the retirement allowance of SERS and TRS and required payments to cover BTRS and COLA contributions were originally established on a "pay-as-you-go" basis. As a result, amounts were appropriated each year to pay current benefits, without a systematic provision to fully fund future liabilities already incurred. Beginning in fiscal year 1988, the Commonwealth enacted the Pension Reform Act of 1987 and addressed the unfunded liability of SERS, TRS and its participation in SBRS and its COLA obligation.

This legislation also directed the Secretary of Administration and Finance to prepare a funding schedule to meet these requirements, and to update this funding schedule every three years on the basis of new actuarial valuation reports prepared under the Secretary's direction. Any such schedule is subject to legislative approval. If a schedule is not so approved, payments are to be

made in accordance with the most recently approved schedule. Under the current schedule adopted in 2004, the amortization payments are designed to eliminate the unfunded liability by fiscal year 2023 on a 4.50% increasing basis. Contributions by the Commonwealth of \$1,216,936,000 were made during the fiscal year ended June 30, 2005. Of this amount \$59,520,000 represents payments for COLA granted to participants in retirement systems of cities, towns and counties. The Commonwealth schedule encompasses SERS, TRS and Boston Teachers.

GAAP requires that pension expenditures (costs) be based on the actuarially required contribution determined using an acceptable actuarial cost method and that they be not less than:

- Normal cost plus amortization of net pension obligation cost
- Interest and amortization on any unfunded prior service costs

The funding schedule discussed above follows an acceptable actuarial funding methodology to compute normal cost and the unfunded accrued actuarial liability.

The following table presents the schedule of employer contributions (amounts in thousands):

Actuarial Valuation as of January 1	Annual Required Contribution (ARC)	Interest on NPO	Amortization of NPO	Pension Cost	Actual Contribution Made	Net Pension (Obligation) / Asset (NPO)	% of ARC Contributed	% of Pension Cost Contributed
State Employees' Retirement System								
2005	\$ 390,867	\$ (102,399)	\$ (88,069)	\$ 376,538	\$ 415,296	\$ 1,279,953	106 %	110 %
2004	349,557	(109,346)	(90,749)	330,960	246,754	1,241,195	71	75
2003	397,698	(117,299)	(96,940)	377,338	280,929	1,325,401	71	74
2002	215,795	(111,506)	(92,152)	196,441	266,660	1,421,811	124	136
2001	275,204	(109,731)	(133,387)	298,861	320,381	1,351,592	116	107
2000	352,084	(108,400)	107,190	350,873	367,000	1,330,071	104	105
1999	319,454	(103,188)	98,556	314,822	378,000	1,313,944	118	120
1998	261,255	(83,446)	77,180	254,989	494,289	1,250,766	189	194
1997	246,037	(65,478)	41,889	222,448	463,590	1,011,466	188	208
1996	232,158	(46,918)	29,523	214,763	433,114	770,324	187	202
Teachers' Retirement System								
2005	699,722	(45,553)	(39,178)	693,347	682,000	540,806	97	98
2004	610,841	(65,373)	(54,255)	599,722	359,476	552,153	59	60
2003	651,021	(83,468)	(68,980)	636,534	417,204	792,400	64	66
2002	411,225	(82,377)	(68,079)	396,927	410,143	1,011,729	100	103
2001	475,053	(78,498)	(95,421)	491,976	539,000	998,513	113	110
2000	480,873	(79,487)	78,599	479,985	468,000	951,489	97	98
1999	373,777	(70,312)	67,155	370,620	481,826	963,474	129	130
1998	315,474	(59,126)	54,686	311,034	446,619	852,267	142	144
1997	245,426	(44,832)	28,681	229,275	418,519	716,682	171	183
1996	232,403	(30,311)	19,073	221,165	392,003	527,439	169	177
Boston Teachers Retirement System								
2005	85,679	7,877	6,775	86,800	86,000	(96,279)	100	99
2004	74,787	5,374	4,460	75,701	45,364	(95,480)	61	60
2003	76,151	3,411	2,819	76,743	52,944	(65,142)	70	69
2002	940,003	(67)	(56)	93,992	51,833	41,343	6	55
2001	66,820	1,542	1,875	66,488	86,000	815	129	129
2000	58,266	448	(443)	58,271	45,000	18,697	77	77
1999	53,453	(989)	944	53,409	36,000	5,426	67	67
1998	48,795	(2,114)	1,995	48,636	35,000	11,983	72	72
1997	34,621	(2,082)	1,332	33,871	35,000	25,619	101	103
1996	32,908	(1,860)	1,171	32,219	34,822	24,490	106	108

**G. *Post-retirement Health
Care and Life Insurance
Benefits***

In addition to providing pension benefits, under Chapter 32A of the Massachusetts General Laws, the Commonwealth is required to provide certain health care and life insurance benefits for retired employees of the Commonwealth, housing authorities, redevelopment authorities, and certain other governmental agencies. Substantially all of the Commonwealth's employees may become eligible for these benefits if they reach retirement age while working for the Commonwealth. Eligible retirees are required to contribute a specified percentage of the health care benefit costs which is comparable to contributions required from employees. The Commonwealth is reimbursed for the cost of benefits to retirees of the eligible authorities and non-state agencies. The Commonwealth recognizes its share of the costs of providing these benefits when paid. These payments totaled approximately \$316,693,000 for the fiscal year ended June 30, 2005. There are approximately 53,334 participants eligible to receive benefits at June 30, 2005.

The Commonwealth has not performed an actuarial valuation of its post-retirement health care and life insurance benefit liability. Private industry typically sees an actuarial accrued liability of 10 to 20 times the current annual payments. For the Commonwealth, this would extrapolate to an actuarial accrued liability of \$2.5 billion to \$5 billion.

The FY04 General Appropriation Act changed the employee contribution rates for group health insurance, with the exception of current employees earning less than \$35,000 and retirees. Current employees as of July 1, 2003 will contribute 20% to their health insurance costs if they earn over \$35,000. New employees will contribute 25%. In fiscal 2006, the contribution rates will return to 15% for all employees.

11. COMMITMENTS

**A. *MBTA and Other
Authorities***

The Commonwealth continues to guarantee certain Massachusetts Bay Transportation Authority (MBTA) debt outstanding at June 30, 2005, totaling \$1,791,835,000.

The MBTA's Forward Funding legislation of 1999 provides for the MBTA to issue general obligation, revenue or other debt secured by a pledge or conveyance of all or a portion of revenues, receipts or other assets or funds of the MBTA. Accordingly, all MBTA debt issued after this legislation is not backed by the full faith and credit of the Commonwealth.

In addition to the residual obligations of the MBTA, the Commonwealth guarantees debt of a number of Public Authorities. At June 30, 2005, the aggregate outstanding debt for which the Commonwealth is obligated to provide contract assistance support totaled approximately \$1,569,206,000 long-term, of which \$687,310,000 is for the Route 3 North Transportation Improvements Association and \$642,390,000 is for the University of Massachusetts Building Authority. No short-term regional transit authority debt is guaranteed.

B. Saltonstall Building

The Massachusetts Development Finance Agency (MDFA) was authorized in legislation to undertake redevelopment of the Saltonstall State Office Building (Building) and its surrounding area. Under the provisions of MDFA's bond authorization, the Building is to be leased by the MDFA for a lease term of up to 50 years with extension terms permitted for an aggregate 30 more years. The MDFA renovated the Building leased half of it back to the Commonwealth for office space and related parking for a comparable lease term. The remainder of the Building and surrounding area has been redeveloped as private office space, housing and retail establishments. The Commonwealth is obligated for future lease payments for space it rents. However, this obligation is not a general obligation or a pledge of credit of the Commonwealth. Though MDFA's bonds are revenue obligations, with pledges of the public and private lease payments, the Commonwealth's lease payments are due upon occupancy and are subject to annual appropriation. The Commonwealth has commenced occupancy of the Building.

C. Central Artery / Tunnel Project

The Central Artery / Tunnel Project is the largest single component of the Commonwealth's capital program according to the finance plan filed as of October 1, 2004. The current cost estimate is \$14.625 billion. The plan includes a maximum obligation of \$8.549 billion from the federal government. The finance plan is currently under review.

At June 30, 2005, the Commonwealth had commitments of approximately \$418,930,000 related to ongoing construction projects. The Central Artery/Tunnel Project continues to anticipate federal participation and payments from the Massachusetts Turnpike Authority (MTA) and the Massachusetts Port Authority (MassPort).

12. CONTINGENCIES

A number of lawsuits are pending or threatened against the Commonwealth, which arise from the ordinary course of operations. These include claims for property damage and personal injury, breaches of contract, condemnation proceedings and other alleged violations of law. For those cases in which it is probable that a loss will be incurred and the amount of the potential judgment can be reasonably estimated or a settlement or judgment has been reached but not paid, the Attorney General estimates the liability to be approximately \$30,000,000 to be paid during FY06. No accrual has been made for this amount in the combined financial statements – statutory basis.

Under the statutory basis of accounting, workers' compensation costs are recognized when claims are presented and paid. The Commonwealth's outstanding liability for such claims at June 30, 2005 is estimated to be \$312,600,000, of which approximately \$39,390,000 is expected to be paid during FY06. No accrual has been made for these amounts in the combined financial statements – statutory basis.

The Commonwealth receives significant financial assistance from the federal government. Entitlement to these resources is generally contingent upon compliance with terms and conditions of the grant or reimbursement agreements and with applicable federal regulations, including the expenditure of the resources for eligible purposes. Substantially all federal financial assistance is subject to financial and compliance audits. Any disallowances become liabilities of the fund, which received the assistance. At June 30, 2005, the Commonwealth estimated that liabilities, if any, which may result from such audits are not material.

Chapter 200A of the Massachusetts General Laws, the Commonwealth's Abandoned Property Law, requires deposit of certain unclaimed assets into a managed Fiduciary Fund. These unclaimed assets are to be remitted to the General Fund each June 30, where it is included as miscellaneous revenue. Amounts remitted during FY05 totaled approximately \$172,502,000. Since inception, approximately \$1,492,533,000 has been remitted. A portion of this amount represents a contingency, because claims for refunds can be made by the owners of the property.

A. Tobacco Settlement

A Master Settlement Agreement (MSA) was executed in November of 1998 between five tobacco companies and 46 states, including the Commonwealth. The MSA called for, among other things, annual payments to the states in perpetuity. These payments have been estimated to total more than \$200 billion over the first 25 years, subject to various offsets, reductions, and adjustments.

In FY05, the Commonwealth received approximately \$257,417,000 or 91% of the estimated amounts shown in the MSA. All received amounts were transferred to the General Fund.

In FY04, a Suffolk Superior Court jury rejected the claims of the Commonwealth's private tobacco attorneys that they should be paid a fee amounting to 25% of the Commonwealth's tobacco settlement money. The jury awarded the plaintiffs 10.5% of the amount the Commonwealth receives under the MSA through 2025. To date, however, the attorneys have received more than 10.5% of what the Commonwealth has received under the MSA. As of June 30, 2005, the Commonwealth owes nothing under the jury award. Whether the Commonwealth will in the future be required to pay any sum on private counsel's claim will depend on the actual payments received by the Commonwealth under the MSA through 2025, as well as on the amounts the attorneys receive through the arbitration payments.

**B. Unemployment
Compensation Fund**

During FY04, the Commonwealth received interest free loans from the federal government to fund the unemployment compensation operating deficit, the fund balance declined by \$368.2 million. All of these borrowings were paid back in May 2004. No additional revenues were needed to be collected from employers in order to pay accrued interest as the loans were interest free. The fund balance in the Unemployment Compensation Fund stands at approximately \$122.5 million as of June 30, 2004. On October 13, 2004, the Commissioner of the Division of Unemployment Assistance announced that further loans will be needed in FY05 to pay unemployment benefits.

13. NON-TAX REVENUE INITIATIVES

Chapter 653, Acts of 1989, amended Chapter 29 of the Massachusetts General Laws by adding Sections 29D and 29E, which authorize certain non-tax revenue initiatives and require reporting thereon, as follows.

A. Debt Collection

Pursuant to Massachusetts General Laws Chapter 29, Section D, Chapter 7A Section 8, allows private debt collection agencies to engage in debt collection for the Commonwealth. The fees paid are contingency based from the proceeds collected. Collections and fees paid during FY05 were:

Department Collectors	Collections	Fees
ACS State & Local Solutions	\$ 1,590	\$ 425
Allen Daniel Associates.....	436	79
Collecto Inc.....	2,231	496
Delta Management Associates, Inc....	531	107
Glenn Associates, Inc.....	786	149
Gragil Associates, Inc.....	79	18
NCO Financial Systems, Inc.....	1	-
OSI Collection Services,, Inc.....	1,153	243
Walker Associates Inc.....	875	140
Windham Professionals, Inc.....	1,398	317
Total.....	<u>\$ 9,080</u>	<u>\$ 1,974</u>

Under the same program, the following amounts were collected and fees paid for institutions of higher education: (These figures are a subset of the above).

Department Collectors	Collections	Fees
Collecto Inc.....	\$ 385	\$ 69
Delta Management Associates, Inc....	1,481	338
Glenn Associates, Inc.....	775	141
NCO Financial Systems, Inc.....	1	-
OSI Collection Services, Inc.....	518	109
Windham Professionals.....	264	56
Total.....	<u>\$ 3,424</u>	<u>\$ 713</u>

B. Revenue Maximization

Pursuant to Massachusetts General Law Chapter 29 Section 29E, contractors were engaged on a contingent fee basis to assist several of the Commonwealth's departments in the identification and collection of federal and other non-tax revenues. During FY05, \$236,445,000 was generated through such efforts, of which \$109,303,000 was credited back to the federal government. After contractor payments of \$8,865,000, the Commonwealth received \$118,277,000.

C. Cost Avoidance

The Comptroller's appropriation authorizes contract arrangements engaged on a contingent fee basis for the purpose of identification and pursuit of cost saving/avoidance opportunities. During FY05, \$374,994,000 of state expenditures were avoided, of which \$142,344,000 would have been funded by the federal government. After contractor payments of \$25,169,000, the Commonwealth had a net cost saving / avoidance of approximately \$207,482,000.

D. Intercept

Intercept is authorized by M.G.L. Chapter 7A Section 3 and 815 CMR 9:06. Intercept is an automated process that offsets Commonwealth payments to delinquent receivables that have been approved by the Office of the State Comptroller. In FY05, the Commonwealth intercepted \$3,692,000 of which \$1,710,000 was on behalf of institutions of higher education.